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No. 03-547

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In the Supreme Court of the United States

UNITED STATES OF AMERICA, PETITIONER

v.

JAMES G. ROBINSON AND BARBARA L. ROBINSON

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

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1. a. Respondents err in asserting (Br. in Opp. 10) that there is no conflict between the decision in this case and the decision of the Sixth Circuit in *Venture Funding, Ltd.* v. *Commissioner*, 110 T.C. 236, 240 (1998), aff'd, 198 F.3d 248 (6th Cir. 1999) (Table), cert. denied, 530 U.S. 1205 (2000). In *Venture Funding*, an employer transferred stock to certain of its employees as compensation for their services in 1988. The transferred stock was not subject to restrictions on further transfer, and the employees therefore should have included the value of the stock they received in 1988 in their respective gross incomes for that year. See 26 U.S.C. 83(a); Pet. 11. The employer, however, did not (i) issue Forms W–2 or Forms 1099 either to its employees or to the Internal Revenue Service to report the value of the transferred stock as income or (ii) withhold any taxes with respect to the transfers. The employees who received the stock did not include any of its value as compensation in their respective 1988 gross incomes. The employer nonetheless claimed a deduction of $1,078,672 for the stock transfers on its 1988 federal income tax return. 110 T.C. at 236–238. The Commissioner disallowed the deduction because it did not corre-

spond to "the amount included" in the employees' incomes, as required by 26 U.S.C. 83(h). 110 T.C. at 238. See Pet. 11. The employer petitioned the Tax Court for a redetermination of the resulting deficiencies, and the court held in favor of the Commissioner, in a reviewed opinion authored by Judge Laro.

The Tax Court majority emphasized that, when an employer pays for services with property (such as stock), 26 U.S.C. 83(h) authorizes the employer to deduct only "the amount included" in the employee's gross income from the in-kind compensation in the year in which that amount "is included in the gross income" of the employee. The court held that this statutory limitation on such deductions is unambiguous and that, because the employees had not included *any* value for the stock they received in their respective incomes for 1988 (and because the employer did not come within either of two potentially applicable safe-harbor provisions contained in regulations), the taxpayer was not entitled to deduct on its 1988 return any amount for the value of the stock it distributed to its employees in that year. 110 T.C. at 238-248.

The dissenting Tax Court judges in the *Venture Funding* case were of the view that 26 U.S.C. 83(h) should be interpreted as though the requirement that the amount be "included" in the employee's income to be deductible should be understood to require, instead, only that the amount be "includible" in the employee's income. 110 T.C. at 259-267. The dissenting judges therefore reasoned that the employer is entitled to the claimed deduction in the year in which its employees *should have* reported as income the value of the stock they received, notwithstanding the failure of the employees to do so. *Id.* at 259.

In an unpublished, per curiam opinion that affirmed the Tax Court's decision, the Sixth Circuit adopted and "agree[d] with the [majority] opinion propounded by Judge

Laro of the Tax Court." *Venture Funding, Ltd.* v. *Commissioner*, 84 A.F.T.R.2d 99-6929, 99-2 U.S. Tax Cas. ¶ 50,972 (6th Cir. 1999), cert. denied, 530 U.S. 1205 (2000).

In reaching a contrary conclusion in this case, the Federal Circuit acknowledged that the Sixth Circuit had agreed with and adopted the holding of the Tax Court majority in the *Venture Funding* case. Pet. App. 16a-17a. The Federal Circuit expressly disagreed with the holding of the Sixth Circuit in *Venture Funding*, however, stating that it was instead "persuaded by the arguments made by * * * the dissenting judges of the Tax Court [in *Venture Funding*]." *Id.* at 17a. The decision of the Federal Circuit in this case thus creates an acknowledged and direct conflict among the circuits on this question of substantial recurring importance.

b. Respondents nonetheless claim that a factual distinction exists between the present case and *Venture Funding* because the issue in *Venture Funding* was "whether the employer was entitled to any deduction at all" (Br. in Opp. 11). Respondents assert that in the present case, by contrast, there is no dispute that respondents are entitled to a deduction in *some* amount and that the only dispute is as to the precise amount to be allowed (*id.* at 11).

As the opinions of the Sixth and Federal Circuits reflect, that asserted distinction has no relevance to the legal issue decided by the courts of appeals. The asserted distinction is, moreover, factually incorrect. Contrary to respondents' assertion, the government's position in this case is that, if the employee is correct that the stock he received was worth only the $2 million he paid for it at the time that he received it, respondents would not be entitled to *any* deduction under Section 83(h). In that circumstance, the employee would have no income to include with respect to the stock and the employer would have no deduction to claim for the distribution of the stock under 26 U.S.C. 83(h). See Pet. 6, 11-12

("the plain text of the statute * * * expressly precludes the employer's present claim for a deduction in this case").

The present case and *Venture Funding* both present the identical issue: whether the employer is entitled to deduct an amount greater than the amount that was actually included in the employee's income with respect to compensation for services paid in property other than money. The disposition of both cases turns on whether the word "included" in Section 83(h) means "actually included" or, instead, means "should have been included" (Pet. App. 15a). If the court below had agreed with the holding of the Tax Court majority and the Sixth Circuit in *Venture Funding*, the employer in this case would not have been allowed to claim a deduction for amounts that have not yet been included in the employee's income. See Pet. 13-14 & n.5. The court below acknowledged, however, that its decision in this case conflicts with the holding of *Venture Funding* and instead adopts and applies the decision of "the dissenting judges of the Tax Court" in that case. Pet. App. 17a. Respondents' assertion that these decisions are not in conflict is thus plainly incorrect.

2. Respondents also err in claiming (Br. in Opp. 8–9) that the decision of the Sixth Circuit in *Venture Funding* "has no precedential value" in that circuit. As we noted in the petition (Pet. 9 n.3), the rules of the Sixth Circuit expressly provide that unpublished decisions of that circuit may be cited as "precedential" when "there is no published opinion" of the circuit on the issue addressed. 6th Cir. R. 28(g).

Respondents stress (Br. in Opp. 9) that such unpublished opinions are not treated as "binding" in that circuit. Unpublished opinions are obviously entitled to careful consideration and given precedential value in that circuit, however, for the circuit rules expressly provide that, when an unpublished opinion is cited for its "precedential" value, the opinion is to be served "on all other parties in the case and on [the]

Court" by "including a copy of the decision in an addendum to the brief." 6th Cir. R. 28(g). Indeed, the Sixth Circuit frequently relies upon the precedential force of its prior unpublished opinions in deciding cases. See, *e.g.*, *United States* v. *Brandenburg*, No. 02-3196, 2003 WL 22905327, at *3 (6th Cir. Nov. 21, 2003); *Thompson* v. *Campbell*, No. 02-5588, 2003 WL 22782321, at *6 (6th Cir. Nov. 20, 2003); *Gettings* v. *Building Laborers Local 310 Fringe Benefits Fund*, 349 F.3d 300, 309 (6th Cir. 2003); *Prince* v. *Island Creek Coal Co.*, 76 Fed. Appx. 67, 69-70 (6th Cir. 2003). The ordinary respect and "precedential" value afforded to an unpublished decision of that circuit is, moreover, enhanced in a case such as *Venture Funding*, due to the fact that the court elected to adopt the thorough discussion and reasoning of the reviewed decision of the Tax Court in that case.

3. Respondents incorrectly assert (Br. in Opp. 13-14) that the conflict between the Federal Circuit's decision in this case and the Sixth Circuit's decision in *Venture Funding* lacks practical significance because the Federal Circuit is a court of national jurisdiction. They claim that any inconsistency between a decision in the Federal Circuit and any other circuit in a tax case would not recur because similarly situated taxpayers would be inclined to bring a refund suit in the Court of Federal Claims (which is bound by the Federal Circuit decision) and that there is therefore "no reason to think that * * * the same issue would arise in" other jurisdictions "in the future" (*id.* at 13).

For the reasons already addressed in the petition (Pet. 9-10), that contention is incorrect. Congress has provided two separate avenues for review of tax determinations. Review in the Tax Court is available for taxpayers who either cannot or will not pay a tax. Review in the district courts and in the Court of Federal Claims is available only for those taxpayers who can and do pay the tax and bring suit for a refund. As a result of the conflict created by the decision in this case, all

cases within the deficiency jurisdiction of the Tax Court will be decided under one interpretation of the statute while all cases within the refund jurisdiction of the Court of Federal Claims will be decided under a conflicting interpretation. See Pet. 9-10 & n.4. The inconsistency between the decision in *Venture Funding* and the decision in this case means that one rule will apply to taxpayers who can afford to pay the tax and file a refund suit in the Court of Federal Claims and a different rule will apply to taxpayers who cannot afford to do so. That inequality of treatment is plainly contrary to the intent of Congress in establishing this dual format for review of tax determinations, and it would result in uneven and unfair administration of the tax laws.

Moreover, even if, contrary to the statutes that Congress has enacted, *all* tax litigation were located in the Federal Circuit, review of the decision in this case would plainly be warranted. This Court has frequently concluded that, even in the absence of a circuit conflict, certiorari review is warranted for decisions of the Federal Circuit that resolve an issue of substantial recurring importance to the public fisc. *E.g.*, *United States* v. *Hill*, 506 U.S. 546, 549 (1993); *United States* v. *Goodyear Tire & Rubber Co.*, 493 U.S. 132, 138 (1989); *United States* v. *American Bar Endowment*, 477 U.S. 105, 109 (1986). For the reasons set forth in the petition (Pet. 22-24), review is warranted for that reason in this case.

4. Respondents claim (Br. in Opp. 14-19) that the decision of the Federal Circuit in this case is correct and therefore need not be reviewed by this Court. We addressed the merits of the court's decision in the petition and explained in detail why it is incorrect (Pet. 10-22). Some of respondents' erroneous assertions, however, warrant a brief response.

a. Respondents note (Br. in Opp. 15) that the government relies not only on the text of the applicable Treasury regulation (26 C.F.R. 1.83-6(a)(1) (1995)) but also on the preamble to the regulation (T.D. 8599, 1995–2 C.B. 12, 13). The

preamble spells out precisely what the agency intended its regulation to mean and thus represents the agency's interpretation of its own regulation. It is appropriate to refer to the preamble of the regulation for this purpose, because it is well established that an agency's interpretation of its own regulations is "of controlling weight unless it is plainly erroneous or inconsistent with the Regulation." *United States* v. *Larionoff*, 431 U.S. 864, 872 (1977) (quoting *Bowles* v. *Seminole Rock & Sand Co.*, 325 U.S. 410, 414 (1945)).

Respondents nonetheless suggest (Br. in Opp. 15) that the preamble should be ignored on the theory that the degree of deference to be given to an agency's interpretation depends on whether the agency interpretation is "contemporaneous and longstanding." Although longevity might add weight to an agency interpretation, the contemporaneous preamble is obviously the best evidence of the agency's intention in adopting the regulations involved in this case. And, because the preamble is plainly not erroneous or inconsistent with the regulation, it should be controlling in any dispute as to the meaning of the regulation.

Moreover, there is no requirement that a regulation be longstanding, or even that it be the agency's initial interpretation of a statute, in order to be entitled to deference under *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843 (1984). The Commissioner is free, at any time, to articulate and adopt a new interpretation of the proper application of a statute. See, *e.g.*, *Thomas Jefferson University* v. *Shalala*, 512 U.S. 504, 517 (1994); *Automobile Club* v. *Commissioner*, 353 U.S. 180 (1957). Whether a new or revised agency interpretation is entitled to deference depends, in each case, on whether it is "based on a permissible construction of the statute." *Chevron U.S.A. Inc.*, 467 U.S. at 843. See also *Barnhart* v. *Walton*, 535 U.S. 212, 226 (2002) (Scalia, J., concurring).

b. Respondents incorrectly assert that "the contemporaneous administrative interpretation of section 83(h) in the original regulation" supports the rule adopted by the court of appeals, in that it refers to the employer's deduction as "the amount *includible* as compensation in the gross income of the service provider, under section 83(a), (b), or (d)(2)" (Br. in Opp. 16). That description of the 1978 regulation is based on a significant omission of text and is therefore misleading.

Even though this issue is addressed in detail in the petition (Pet. 15-18), respondents fail to mention that the 1978 regulatory language on which they seek to rely did not purport to interpret the statute. Instead, it established a safe-harbor for employers that applied "*only if* the employer deducts and withholds" the amount of taxes that would be due if the employee reported the income for which the employer claims a deduction. 26 C.F.R. 1.83–6(a)(2) (1979) (emphasis added). An employer who failed to withhold that amount as tax, and who thus failed to come within the safe harbor, was denied a deduction for in-kind compensation except to the extent that such compensation was actually "included" in the employee's gross income. 26 C.F.R. 1.83-6(a) (1979); see Pet. 15 n.6. Because respondents did not deduct or withhold any amounts from the employee's pay, they would not have come within that regulatory safe harbor even if the 1978 regulation applied to this case (which, since that regulation had been superceded by the 1995 regulation, it did not). See Pet. 15-16. For these reasons, the court of appeals did not seek to rely on the provisions of the expired 1978 regulation, and respondents' invocation of that regulation is simply misplaced.

5. Respondents also err in asserting that this case lacks sufficient recurring importance to warrant review by this Court. Respondents claim that the decision of the court of appeals is of little importance because it "simply allows an

employer to take a deduction for the actual cost of its compensation expense, in a case where the IRS is fully able to protect its interests by litigating against the employer and by proceeding against the employee." Br. in Opp. 21.

In making this assertion, respondents fail to confront the fact that the decision in this case purports to invalidate the governing 1995 regulations on the theory that "the meaning of the statute is clear." Pet. App. 15a. Under the decision in this case, an employer can claim a deduction, regardless of "the amount included" in the employee's income (26 U.S.C. 83(a)), and the employee can thereafter inconsistently claim that only the amount he has included in his income is subject to tax. The potential for a "whipsaw" result is obvious under the court's interpretation of the statute. A wasteful multiplication of litigation over the same fact-intensive issue would also be a direct result of the court's holding.

Moreover, if, as the court concluded in this case, employers are allowed to deduct an amount different from the amount reported to the Internal Revenue Service on a contemporary Form W-2 or Form 1099, the Service is unlikely ever to learn of the inconsistency.[1] As a practical matter, the Service plainly has insufficient resources to audit more than a small fraction of the returns that are filed. The Service relies heavily on document matching to determine whether employees and other service providers report the correct amount of income. Without accurate information from these required reports, the Service will have nothing to match and nothing to compare to ensure accuracy. By providing eco-

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[1] Respondents plainly errs in suggesting (Br. in Opp. 19 n.6) that the Service's position in this case would preclude an employer from making a refund claim within the applicable statute of limitations. As we explain in the petition (Pet. 14 n.5), the employer may make a timely refund claim and thereby preserve its position on the issue even though the audit or other proceedings required to determine the amount to be included in the employee's income from the transfer of property has not yet been completed.

nomic incentives for incomplete or inaccurate reporting of payments of in-kind compensation, the decision in this case creates a serious likelihood of a substantial, recurring underreporting of income. As a consequence, it is evident that a substantial loss of tax revenues will result from the decision in this case.

Moreover, even in the unusual case in which the Service is able to detect the inconsistency and issue a timely deficiency notice to both the employer and employee before the statute of limitations expires, the decision in this case is certain to multiply litigation and yield inconsistent results. A writ of certiorari is warranted in this case to avoid such inefficiencies in the determination of taxes and to prevent the resulting "inequalities in the administration of the revenue laws." *Commissioner* v. *Sunnen*, 333 U.S. 591, 599 (1948).[2]

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For the foregoing reasons, and those stated in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted.

THEODORE B. OLSON
Solicitor General

DECEMBER 2003

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[2] Respondents' discussion of the valuation of options that are *not* governed by Section 83(a) (Br. in Opp. 22) is irrelevant. Incentive stock options are subject to a dollar limitation of $100,000 per year. 26 U.S.C. 422(d). Employee stock purchase plans are also subject to a dollar limitation of $25,000 per calendar year. 26 U.S.C. 423(b). The fact that certain types of stock options issued to employees do not provide deductions for employers is obviously irrelevant to the present case, which potentially involves vast amounts of deductions for stock and other property transferred to employees as compensation in-kind.